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FINANCIAL SITUATION OF UNIDO

Report of the External Auditor on the interim accounts of the United Nations Industrial Development Organization and of the Industrial Development Fund for the first year of the fiscal period 1996-1997 ended 31 December 1996*

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LETTER OF TRANSMITTAL

Sir,

I have the honour to present to the Programme and Budget Committee my report on the interim accounts for the first year of the financial period 1996-1997 ended 31 December 1996.

Accept Sir, the assurances of my highest consideration.

[*Signed*]

Dr. H. von Wedel
President of the Federal Court of Audit
Germany
External Auditor

Enclosures

The Chairperson of the Programme and
Budget Committee
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I. GENERAL

1. I have audited the accounts of the United Nations Industrial Development Organization (UNIDO) for the financial period 1 January 1996 to 31 December 1996 in accordance with Article XI of the Financial Regulations of the Organization and the "Additional terms of reference governing the audit of UNIDO" appended thereto.

2. The audit was carried out by staff of the German Federal Court of Audit at UNIDO Headquarters in Vienna. The examinations were performed in accordance with generally accepted auditing standards, conforming with international standards, and with the common auditing standards adopted by the Panel of External Auditors of the United Nations, the specialized agencies and the International Atomic Energy Agency. Consequently, my work did not involve a detailed review of all aspects of UNIDO's budgetary and financial information system and the results cannot be regarded as a comprehensive statement on them.

3. In line with established audit practice and procedures the findings and conclusions contained in this report have been discussed by the audit team with senior officials of the Organization and their comments and observations have been incorporated in the report where possible and appropriate.

II. SUMMARY OF FINDINGS AND CONCLUSIONS

4. In the financial statements for the first 12-month period of the biennium 1996-1997, and for the first time in its history UNIDO established a provision for delay in the collection of assessed contributions. The new accounting practice is in line with recommendations made by the Panel of External Auditors of the United Nations, the specialized agencies and the International Atomic Energy Agency.

5. In total, the contributions receivable as at 31 December 1995 not paid by 31 December 1996, amount to $61,825,200. The provision for delay leads to a shortfall of income over expenditure of $35,984,600 for the financial year 1996. Taking into account the unpaid contribution of the United States of America of $28.7 million for the current biennium not yet included in this provision, the financial statement would reflect negative reserves and fund balances of $3,339 million.

6. UNIDO used up all available reserves towards the end of the year 1996. In 1997 opening cash has dropped to $900,000 only, so there is reason for serious concern about the ability to pay future liabilities. It is imperative that outstanding assessed contributions are paid as soon as possible to alleviate the serious financial crisis.

7. In case another staff reduction exercise becomes necessary, it may not be possible to fund a reserve for separation benefits, as the surplus for the 1994-1995 biennium is presently not backed up by cash resources.

III. BUDGETARY, ACCOUNTING AND FINANCIAL REPORTING PROCEDURES

8. Our examination of the financial statements and supporting schedules revealed that UNIDO's financial situation has declined dramatically. UNIDO is facing financial risks.

A. Arrears of assessed contribution

9. In October 1996 we drew the Administration's attention to the risks resulting from UNIDO's practice of accounting for unpaid assessed contributions at the nominal value without any depreciation or provision for possible non-payment. This practice, which takes no account of the date of origin or the solvency or the debtor's willingness to pay is common accounting practice in the United Nations system. However, this practice leads to the result that in case of major arrears of assessed contributions receivable, the assets are presented more valuable than they really are. The same applies for the surplus that seems to be available for UNIDO for distribution to the Member States.

10. In the financial statements for the first 12-month period of the biennium 1996-1997, and for the first time in its history, UNIDO established a provision for delay in the collection of assessed contributions. The provision comprises arrears of contributions receivable from Member States as at 31 December 1995 not paid by 31 December 1996 amounting to $61,825,200. The transfer to the provision for delay leads to a shortfall of income over expenditure of $35,984,600.

11. This new accounting practice is in line with recommendations made by the Panel of External Auditors of the United Nations, the specialized agencies and the International Atomic Energy Agency. We welcome the establishment of the provision for delay.

12. There are two reasons for the great impact of the provisions for delay on the financial statements. First, as UNIDO has established the provision for delay for the first time, the actual amount covers the backlog for the bienniums prior to 31 December 1995. Secondly, the United States of America left UNIDO with arrears of $64.5 million. $35.8 million of this amount is already included in the provision for delay. The remaining $28.7 million is due in the biennium 1996-1997. This amount is not included in the current provision for delay but, if it remains unpaid, will take effect in the next biennium. This could result in an excess of expenditures over income in 1998-1999.

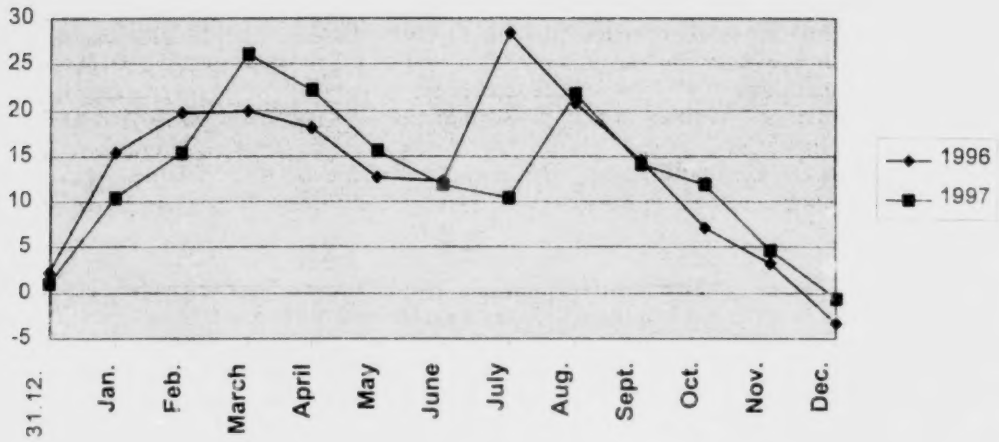
13. In order to give an impression of the impact of the provision for delay, we have contrasted the surplus of the first year of the biennium 1996-1997 without any provision for delay with the surplus as shown in the statement of income and expenditure.

14. The introduction of the new accounting policy ensures that a more realistic value of the Organization's assets and reserves is disclosed in the financial statement.

Impact of the provision for delay

(In thousands of United States dollars)

	Version 1 (without provision for delays)	Version 2 (provision for delays until 31.12.1995)
Income		
Assessed contributions	108,908.9	108,908.9
Other income	14,333.6	14,333.6
Total expenditure	-97,491.2	-97,491.2
EXCESS/SHORTFALL OF INCOME OVER EXPENDITURE	25,751.3	25,751.3
Provision for delays	0	-61,825.2
Other	89.3	89.3
NET EXCESS/SHORTFALL OF INCOME OVER EXPENDITURE	25,840.6	-35,984.6
Transfers and credits	-9,211.2	-9,211.2
Reserves and balances, beginning of biennium	70,594.2	70,594.2
RESERVES AND FUND BALANCES, END OF 1996	87,223.6	25,398.4



B. Cash flow

15. According to Treasury's cash flow forecast for 1996, as of 31 January 1996 there were no major cash flow problems foreseen for 1996 in the short run assuming that staff members were reduced to the contingency plan levels as planned and the major contributors paid as predicted. The same applies for the 1997 forecast according to the analysis as of 5 February 1997. The monthly cash balances for 1996 included the use of the Working Capital Fund. In the above chart we compare the monthly closing cash balances of the respective years.

16. However, towards the end of 1996 UNIDO in fact faced severe cash problems. In order to be able to pay the salaries, Treasury delayed a number of other payments due until cash was available during the last days of 1996. Cash related to the separation indemnity reserve balance was set aside. These measures helped UNIDO to overcome the critical situation.

17. In 1997 it can be expected that the problems will increase. It must be noted that, before the end of 1996, several Member States paid their 1997 contributions amounting to a total of $1.3 million in advance. These funds had to be used to settle bills and were, therefore, not available in 1997.

18. There are some important differences between the two years. In 1996 funds were available in the Working Capital Fund and opening liquid cash balances amounted to $2.3 million. In 1996, however, UNIDO used up all available cash reserves towards the end of the year. In 1997, opening cash has dropped to $900,000 only. This gives reason for serious concern about the Organization's ability to pay future liabilities. Furthermore, the Organization is forced to delay the financial implementation of the budget due to projected cash shortfalls. The reserves are depleted. Therefore, cash outflows have to be funded exclusively from cash inflows on a month-to-month basis.

19. For the Organization to be in a reasonably secure financial position, the Working Capital Fund should be fully replenished and the minimum cash balances at the end of 1997 should be equal to the value of unliquidated obligations. Taking all the above factors into account we consider that a timely and complete collection of assessed contributions is most crucial.

C. Financial risks for UNIDO

20. In the light of the reported financial constraints the announcements of some Member States to withdraw is most problematic for UNIDO. As it can be expected that the countries in question pay their still outstanding contributions for 1997, the withdrawals would have the consequence of a further reduction of contributions beyond 1997 only. However, this reduction of income will require further budget reductions for 1998-1999, including reduction of expenditures, especially personnel costs. This process has to be started early enough to be able to plan and assess the effectiveness sufficiently.

21. We stress that in case another staff reduction exercise becomes necessary, it may not presently be possible to fund a reserve for separation benefits, as the surplus for the 1994-1995 biennium is not backed up by cash resources. Therefore the Member States would be obliged to provide additional funds for that purpose.

ACKNOWLEDGEMENT

I wish to express my appreciation of the cooperation and assistance extended by the Director-General and the staff of UNIDO, in particular the staff of Financial Services.

[*Signed*] Dr. H. von Wedel
President of the Federal Court of Audit
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External Auditor